



Appeal of Cecil W. Harris

Fearing seizure of the business assets to satisfy state and federal tax liabilities, appellant formed a separate corporation, Barbara's Steno and Mailing Service, Inc., dba Paramount Printing. According to appellant, the new corporation was formed 'to maintain present business contacts and banking relations and to generate new contacts for his **sole** proprietorship business, and to provide income in the event of foreclosure by governmental agencies."

Between April 15, 1968, and April 6, 1970, appellant made forty-seven separate cash advances to Paramount Printing totaling **\$38,781.69**. The advances were carried on C. W. Harris Electric's books as "loans receivable" but were not evidenced by notes or any other writing and were not subject to any repayment, interest, or security provisions. Paramount Printing never repaid any of those advances. In December of 1969, appellant cancelled any obligation on the part of Paramount Printing to repay the advances which had been made, and on March 24, 1970, the corporation was sold to a third party.

Most of the "loans receivable" were subsequently reclassified as bad debts on the books of C. W. Harris Electric and were deducted as such on appellant's personal income tax returns for 1969 and 1970. Respondent disallowed these deductions and proposed the assessments now on appeal.

The sole question for our determination **is** whether appellant was entitled to his claimed bad debt deductions.

Section 17207 of the Revenue and Taxation Code allows the deduction of a debt which becomes worthless within the taxable year. The first step **in determining** entitlement to this deduction is to determine that a bona fide debt existed. (See Cal. Admin. Code, tit. 18, reg. 17207(a), **subd. (3).**) This determination is a question of fact and where, as here, the "debts" arose from advances made by the taxpayer to his wholly owned corporation, he carries the heavy burden of proving that bona fide debts were created. (See Appeal of George E. Jr., and Alice J. Atkinson, Cal. St. Bd. of Equal., Feb. 18, 1970; Appeal of Andrew J. and Frances Rands, Cal. St. Bd. of Equal., Nov. 6,

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**1967; Appeal of George E. Newton, Cal. St. Bd. of Equal., May 12, 1964.)**

While no single factor is controlling, we have found the most important factor in determining the existence of a true debt under circumstances like these to be an unconditional obligation on the part of the so-called debtor to repay a definite sum of money. (See Appeal of Estate of John M. Hiss, Sr., Deceased, and Ella N. Hiss, Cal. St. Bd. of Equal., Sept. 23, 1974.) No such obligation was evidenced in this case. Additionally, none of the money advanced was ever repaid by Paramount Printing, nor were any of the advances secured, subject to interest, **or** evidenced by notes or other formal indicia of indebtedness. Under these circumstances, appellant has not sustained his burden of proof and we must conclude the advances were not bona fide debts. It follows that they could not have become worthless and therefore were not deductible bad debts as claimed.

Based on the foregoing we have no alternative but to sustain respondent's determination in this matter.

O R D E R

Pursuant to the views expressed in the opinion of the board **on** file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Cecil W. Harris against proposed assessments of additional personal income tax in the amounts of \$3,625.85 and \$930.93 for the years 1969 and 1970, respectively, be and the same is hereby sustained.

Done at Sacramento, California this 6th day of January, 1977, by the State Board of Equalization.

*William B. Bennett*, Chairman  
*Paul J. Herr*, Member  
*George H. Healy*, Member  
*Mrs. Sanku*, Member  
\_\_\_\_\_, Member

ATTEST:

*W. W. Lintop*, Executive Secretary